91-1132

No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

FREEPORT-McMoRan INC., et al.,

Petitioners,

versus

K N ENERGY, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

1. Does *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), sanction the creation of a federal rule of contract law distinguishing the words "terms" and "conditions"?

2. If so, should such a federal rule be adopted?

3. Does Rule 52(a), Fed. R. Civ. P., permit a court of appeals to conduct a *de novo* review of a trial court finding that is based on extrinsic evidence?

STATEMENT PURSUANT TO RULES 14.1(b) AND 29.1

Two of the parties to the proceeding in the court of appeals no longer exist. On March 30, 1990, Freeport-McMoRan Operating Company, a Limited Partnership, merged into its affiliate, Freeport-McMoRan Oil & Gas Company. On April 2, 1990, McMoRan Oil & Gas Company merged into its parent, Freeport-McMoRan Inc.[1] All other parties appear in the caption of the case.

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[1] Freeport-McMoRan Inc. has no parent company. Its non-wholly owned subsidiaries are Notel, Inc., St. Laurens Harbor Storage Company, American Sulphur Export Corp., Barton Creek Properties, Inc., C. L. Dill Co., Inc., PT Freeport Indonesia Company, Freeport-McMoRan Copper & Gold Inc., and Freeport-McMoRan Insurance Co., Ltd.

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OCTOBER TERM, 1991

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versus *Petitioners,*

K N ENERGY, INC.,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

INTRODUCTION

Petitioners, Freeport-McMoRan Inc. and Freeport-McMoRan Oil & Gas Company, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit, reversing the decision of the United States District Court for the District of Colorado.

OPINIONS BELOW

The opinion of the court of appeals is reported at 942 F.2d 765. The final judgment entered by the district court is unpublished. Both are reproduced in the appendix ("app.") at pp. A-1 and A-16. The orders of the court of appeals denying rehearing are reproduced at app. pp. A-12 and A-14. The district court's findings, announced orally to the parties, are reproduced at app. p. A-18.

JURISDICTION

The judgment of the court of appeals was entered on August 19, 1991. App. p. A-1. A timely petition for rehearing was denied on October 16, 1991. App. pp. A-12 and A-14. Jurisdiction exists under 28 U.S.C. § 1254.

CONSTITUTIONAL AND STATUTORY PROVISIONS AND RULES INVOLVED

U.S. Const. amend. X provides:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.

28 U.S.C. § 1652 provides:

> The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Rule 52(a), Fed. R. Civ. P., provides in pertinent part:

> Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.

STATEMENT OF THE CASE

Respondent K N Energy, Inc. ("KN") is an interstate pipeline company that buys natural gas under a long-term contract covering approximately 500,000 acres leased in Montana by Petitioners Freeport-McMoRan Inc. and Freeport-McMoRan Oil & Gas Co. (collectively, "Freeport"). The contract was originally made in 1973 between KN and its wholly-owned subsidiary, Midlands Gas Corporation ("Midlands").

In 1975, when KN was experiencing gas shortages, the contract was amended. As incentives for the seller to dedicate to KN an additional 123,000 acres, various pricing provisions were added to the contract. One of these, Section 8.1F, gave the seller the exclusive option, in the event any of the gas became free from price regulation, to request a redetermination of the price for such gas. The redetermined price was to be "the highest price then being paid . . . by interstate and intrastate pipeline companies in Phillips and Valley Counties, Montana for gas of similar quantity and quality and being *sold under similar terms and conditions*." (Emphasis added.)

In December 1984, Freeport acquired Midlands and succeeded to its interest as the seller under the gas purchase contract. At the time of the acquisition, KN was paying $3.845 and $4.118 per MMBtu (million British thermal units), respectively, for two categories of regulated gas covered by the contract.

In January 1985, those gas categories became freed from price controls pursuant to the phased deregulation schedule of the Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3342. That same month, KN announced that the price for the newly deregulated gas would be reduced to 62¢ per MMBtu.

Freeport immediately protested KN's attempted price reduction and, under the above-quoted provision of Section 8.1F of the contract, requested redetermination of the contract price to the highest price being paid in the area. The

highest price then being paid was for a category of gas which was still regulated.

This litigation ensued in the United States District Court for the District of Colorado. Subject matter jurisdiction was grounded upon diversity of citizenship, 28 U.S.C. § 1332(a). At trial, KN argued that the contract price for deregulated gas could not be redetermined on the basis of a price paid for regulated gas, because regulated gas was not "sold under similar terms and conditions." The district court rejected this position, holding that the contracting parties did not intend the status of gas as regulated or unregulated to be considered a "term" or "condition" of sale. Judgment was entered for Freeport, and KN appealed.

On August 19, 1991, the court of appeals reversed the district court's judgment.[2] The court held that "the use of 'terms'," in the contract's price redetermination provision referring to gas "sold under similar terms and conditions," "is peculiar to the nomenclature of contract law and not a synonym nor interchangeable with 'conditions'. " App. p. A-7. On the basis of that perceived rule of contract law, the court concluded that deregulation "was a 'term' of the sale" although it was not a "condition" of sale. App. pp. A-7, A-8.

This result was announced *sua sponte*, without briefing or argument.

On October 16, 1991, the court of appeals denied without comment Freeport's petition for rehearing. App. p. A-12.

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[2] Earlier, the same panel of the court of appeals, in an opinion by the same judge, had directed that the case be dismissed, holding that under *Carden v. Arkoma Associates*, 494 U.S. 185 (1990), the addition late in the litigation of a nonessential, nondiverse Freeport affiliate destroyed diversity jurisdiction. That decision, announced by the court of appeals *sua sponte* without briefing or argument, was reversed by this Court on February 11, 1991. *Freeport-McMoRan Inc. v. K N Energy, Inc.*, ___ U.S. ___, 111 S.Ct. 858 (1991), *rev'g McMoRan Oil and Gas Co. v. K N Energy, Inc.*, 907 F.2d 1022 (10th Cir. 1990).

REASONS FOR GRANTING THE WRIT

I. THE DECISION BELOW CONFLICTS WITH THE SETTLED RULE OF THIS COURT THAT THERE IS NO FEDERAL GENERAL COMMON LAW.

Until the decision below, no rule of federal jurisprudence had been more firmly rooted than the precept that, "[e]xcept in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state." *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938). For over half a century, federal courts had heeded the admonition of Justice Brandeis that "[t]here is no federal general common law." *Id.* at 78.

The decision below simply disregards the *Erie* mandate. In a matter purely of contract interpretation, the opinion omits to consider which state's law is applicable and what the contract law of that state provides.[3]

The court of appeals believed that its distinction between "terms" and "conditions" of sale rested upon general law, citing a definition of "term" found in the *Restatement of Contracts*. App. p. A-7.[4]

But nothing in the *Restatement of Contracts* suggests the distinction embraced by the opinion below. The *Restatement*'s definition of "term" invoked by the court of appeals, and the related commentary (*see* App. p. A-7 n. 12), invite no contrast with the word "condition." Indeed, the *Restatement* emphasizes the interchangeable nature of the words: "Sometimes it ['condition'] is used . . . to refer to

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[3] The opinion of the court of appeals does not refer to a single state law decision.

[4] "A term of a contract is that portion of the legal relations resulting from the promise or set of promises which relates to a particular matter, whether or not the parties manifest an intention to create those relations." *Restatement (Second) of Contracts* § 5 (1981).

any *term* in an agreement (e.g., 'standard conditions of sale')." *Restatement (Second) of Contracts* § 224 cmt. a (1981) (emphasis added).

Nor do other authorities support the distinction adopted by the court of appeals. According to the dominant modern treatise in this area of the law, "[i]n contract writing, it ['condition'] is often used as synonymous with 'term'." 3A A. Corbin, *Corbin on Contracts* § 627, at 11 (1960). Conversely, *Black's Law Dictionary* defines "term" as, *inter alia*, a "condition in a contract." *Black's Law Dictionary* 1460 (6th ed. 1990).

Conspicuously absent in this diversity action is any acknowledgment by the court of appeals of the plethora of state law decisions establishing a long-standing common law rule that "terms" and "conditions" are treated as interchangeable in contractual interpretation[5] as well as in

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[5] " '[T]erms' and 'conditions' often used synonymously . . . are technical words of well-defined legal meaning. As used in contracts generally, they mean the propositions, limitations, and exactions which comprise in whole or in part the agreement." *Staebler-Kempf Oil Co. v. Mac's Auto Mart, Inc.*, 45 N.W.2d 316, 318 (Mich. 1951) (quoting *City of Detroit v. Detroit United Railway*, 139 N.W. 56, 59 (Mich. 1912), *rev'd on other grounds*, 242 U.S. 238 (1916)). *Accord, Rhoads Drilling Co. v. Allred*, 70 S.W.2d 576, 581 (Tex. Com. App. 1934) (" 'terms' . . . when used with respect to . . . contracts . . . is construed as embracing the conditions"); *Blackburn v. Bozo*, 26 P.2d 542, 543 (Utah 1933)("the word 'terms,' which is said in 38 Cyc. 184, . . . 'as used chiefly in reference to contracts,' to signify 'the conditions, limitations, and propositions' "); *Roberts-Atkinson Co. v. International Harvester Company of America, Inc.*, 131 S.E. 757, 760 (N.C. 1926)("In the law of contracts . . . 'terms' are conditions, propositions stated, or promises made.")(quoting *Black's Law Dictionary* 1146 (2d ed. 1910)); *Logansport & Wabash Valley Gas Co. v. Null*, 76 N.E. 125, 126 (Ind. App. 1905) ("The word 'terms' . . . was broad enough to include . . . conditions."); 86 C.J.S. *Term* 603-604 (1954) ("the word 'terms' . . . with respect to contracts . . . signifies the conditions") (footnotes omitted).

other contexts.[6] This rule, rather than the court of appeals' distinction, is observed by the highest court of states with a connection to this contract law dispute,[7] such as Montana,[8]

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[6] *In re Complaint by the Township of Morris*, 229 A.2d 516, 522 (N.J. 1967) (statute) ("The words 'terms and conditions' are often used synonymously and interchangeably."); *People ex rel. Moore v. J.O. Beekman & Co.*, 179 N.E. 435, 437 (Ill. 1931) (statute) ("Webster's Dictionary defines the word 'terms' as synonymous with the word 'conditions'."); *Yazoo & M.V.R. Co. v. Scott*, 67 So. 491, 495 (Miss. 1915) (statute) ("The words 'terms' and 'conditions,' however, as here used, are synonymous."); *Doyle v. Jorgensen*, 414 P.2d 707, 711 (Nev. 1966) (procedural rule) ("We construe 'terms' in the context used to mean reasonable conditions."); *McDowell v. Harris*, 107 S.W. 2d 647, 649 (Tex. Civ. App. 1937) (will) ("The word 'terms' in such clause clearly means the conditions upon which the beneficiary was given title.").

[7] As noted above, the court of appeals attempted neither to ascertain which state's law governed this dispute nor to follow the law of any state.

[8] The Montana Supreme Court regularly uses "terms" and "conditions" interchangeably. *See, e.g., Smith v. Johnson*, 798 P.2d 106, 109 (Mont. 1990) (referring to the subjects of contract negotiations interchangeably as "additional terms," "supplemental terms and conditions," and "provisions or conditions the parties might have incorporated"); *Mountain West Farm Bureau v. Neal*, 547 P.2d 79, 81-82 (Mont. 1976) ("terms and conditions as set forth in the policy," "the terms thereof"); *Somont Oil Co., Inc. v. Nutter*, 743 P.2d 1016, 1019 (Mont. 1987) ("terms and "conditions," "general terms," "provisions or conditions"); *Mountain State Highway Patrol Officers v. Board of Personnel Appeals*, 676 P.2d 194, 198 (Mont. 1984) ("the contract included a term or condition"); *Doug Johns Real Estate, Inc. v. Banta*, 805 P.2d 1301, 1302 (Mont. 1990) ("terms," "terms and conditions"); *Reilly v. Maw*, 405 P.2d 440, 443 (Mont. 1965) ("provisions and conditions," "such conditions").

where the contract is performed, and Colorado,[9] where defendant buyer resides.[10]

The opinion below squarely presents this Court with a challenge to *Erie*. Without regard to, and indeed at odds with, state law, the court of appeals has erected a federal rule of general contract law distinguishing between two of the most frequently used words in contracts — "terms" and "conditions." Such an attempt to "fashion rules which are not supported by a grant of federal authority contained in . . . the Constitution," *Hanna v. Plumer*, 380 U.S. 460, 471 (1965), bespeaks nothing less than a return to the discredited doctrine of *Swift v. Tyson*, 41 U.S. (16 Pet.) 1 (1842),

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[9] *See Hurd v. Whitsett*, 4 Colo. 77, 84 (1878) ("The word 'terms' in the plural form, in its restricted and legal sense, and as used chiefly in reference to contracts, means the conditions, limitations, and propositions.").

[10] Even if it had not been clear how the relevant state's supreme court would resolve the issue of contract law herein presented, the court of appeals would not have been excused from this inquiry. *See Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 208 (1956) (concurring). Federal courts are not "free to choose their own rules of decision whenever the highest court of the state has not spoken," but rather must attempt "to ascertain from all the available data what the state law is." *West v. American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940).

The Court could use this opportunity to explore what comprises "all the available data" which federal courts should examine in determining state law. Such data surely would encompass more than the inapposite provision from the *Restatement of Contracts* relied upon by the opinion below. *See generally Michelin Tires (Canada) Ltd. v. First National Bank of Boston*, 666 F.2d 673, 682 (1stCir. 1981); *Patch v. Stanley Works (Stanley Chemical Co. Div.)*, 448 F.2d 483, 488 (2d Cir. 1971); *Gruber v. Owens-Illinois Inc.*, 899 F.2d 1366, 1369-1370 (3d Cir. 1990); *Stephens v. State Farm Mutual Automobile Ins. Co.*, 508 F.2d 1363, 1366 (5th Cir. 1975); *Grantham and Mann, Inc. v. American Safety Products, Inc.*, 831 F.2d 596, 608 (6th Cir. 1987); *Robak v. United States*, 658 F.2d 471, 475 (7th Cir. 1981); *Kifer v. Liberty Mutual Ins. Co.*, 777 F.2d 1325, 1334 (8th Cir. 1985); C. Wright, *Law of Federal Courts* § 58, at 375 (4th ed. 1983); 1A-Pt. 2 J. Moore, *et al.*, *Moore's Federal Practice* ¶ 0.308[2], at 3088-3090 (2d ed. 1991).

with, as Justice Frankfurter remarked, its attendant "disregard of the basic nature of diversity jurisdiction, namely, the enforcement of state-created rights." *Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 208 (1956) (concurring). If the rule of *Erie* is not to be a dead letter, the decision below should be corrected.

II. THE DECISION BELOW CREATES SIGNIFICANT UNCERTAINTY IN THE ENFORCEMENT OF CONTRACTS.

The failure of the opinion below to respect state contract law must be of particular concern to this Court not only because the basis for the court of appeals' novel rule is unclear, but also because the language covered by the court's rule is so commonly employed.

Justice Harlan advised that the driving force behind *Erie* is "that there should not be two conflicting systems of law controlling the primary activity of citizens, for such alternative governing authority must necessarily give rise to a debilitating uncertainty in the planning of everyday affairs." *Hanna v. Plumer*, 380 U.S. 460, 474 (1965) (concurring).

The decision below creates such uncertainty in at least two respects. First, it spins a gossamer distinction between the phrases "conditions of sale" and "terms and conditions of sale" which does not exist under state law. Parties must therefore now expect that judicial interpretation of their contracts will hinge on whether the action is brought in state court or federal court. Second, the court of appeals gives no guidance as to the application of this hitherto unknown distinction. Parties entering into contracts have little hope of understanding the implications of the language they choose, since the source the court of appeals draws upon, the *Restatement of Contracts*, itself does not recognize the distinction.

The case at hand amply demonstrates the dramatic effect this distinction has in the interpretation of long-term gas

purchase contracts. Virtually without exception, such contracts involve millions of dollars and the allocation of a critical natural resource.

Nor is the impact of the decision below confined to gas contracts. It is impossible to enumerate fully how many contracts of all kinds utilize the language discussed by the court of appeals or variations thereof, each of which contracts may now be subjected to different rules of decision in state and federal courts.

The mischief gratuitously wrought by the court's bizarre and elusive dichotomy is apparent. It will stand as an open invitation to engage in forum shopping, spawning needless litigation and driving a wedge between the federal and state systems — precisely the harm *Erie* was intended to avert.

Given the lack of justification for the court's novel rule, the number, scope, and importance of the contracts affected, and the potential for years of unnecessary litigation, the uncertainty generated by the decision below is unacceptable. As Justice Cardozo once warned, "The attempted distinction . . . will plunge this branch of the law into a Serbonian Bog." *Landress v. Phoenix Mutual Insurance Co.*, 291 U.S. 491, 499 (1934) (dissenting).

III. THE DECISION BELOW CONFLICTS WITH THE "CLEARLY ERRONEOUS" STANDARD FOR REVIEW OF FINDINGS BASED ON EXTRINSIC EVIDENCE.

The standard of review applied in this case by the court of appeals failed in two respects to pass muster under the decisions of this Court and under Rule 52(a) of the Federal Rules of Civil Procedure.

First, "[t]he Court of Appeals never identified the standard of review that it applied to the District Court's factual findings." *Amadeo v. Zant*, 486 U.S. 214, 223 (1988). Second, the opinion below disregarded the requirement articulated by

this Court in *Amadeo* that, where the district court's finding is one of fact, even if the appeals court does not acknowledge the factual nature of the finding, it must be accorded a deferential, "clearly erroneous" standard of review. *Id.*[11] The "clearly erroneous" standard is specified by Fed. R. Civ. P. 52(a), which mandates that particular deference be accorded to "the opportunity of the trial court to judge of the credibility of the witnesses."

The district court determined as a factual matter that the parties did not intend the regulatory status of gas to be a term or condition under the contract's clause allowing the seller to obtain a redetermination of the price to the highest price paid for gas "sold under similar terms and conditions." This finding rested on extrinsic evidence beyond the written instrument itself, particularly the testimony of the expert witness, Dr. William Talley, whom the court found to be "a very knowledgeable and credible witness." App. pp. A-21, A-25.

The court of appeals did not share the district court's evaluation of the evidence:

> The *testimony* established this provision was drafted in anticipation of price deregulation, with each party giving up certain consideration to implement the repricing mechanism. The resulting natural gas price established by ¶ 8.1F was *intended* to exist only in a deregulated arena. While this deregulated setting may not be a "condition" of sale, it was *contemplated* as a "term" of sale.

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[11] Even as to "mixed questions of law and fact," the same deferential standard "is warranted when it appears that the district court is 'better positioned' than the appellate court to decide the issue in question or that probing appellate scrutiny will not contribute to the clarity of legal doctrine." *Salve Regina College v. Russell*, ____ U.S. ____, 111 S. Ct. 1217, 1222 (1991).

App. p. A-8 (emphasis added) (footnote omitted).

However, although the court of appeals disagreed with the trial court's finding as to the parties' intentions, the "clearly erroneous" standard "plainly does not entitle a reviewing court to reverse the finding of the trier of fact simply because it is convinced that it would have decided the case differently." *Anderson v. Bessemer City*, 470 U.S. 564, 573 (1985). Rather, "[i]n applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*." *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969).

The court of appeals flatly disregarded the "clearly erroneous" standard by conducting a *de novo* review of the evidence and arrogating to itself the trial court's function.

CONCLUSION

A writ of certiorari should be granted to review the judgment and opinion below.

Respectfully submitted,

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January 1992

APPENDIX A

PUBLISH

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Nos. 89-1068, 89-1098

McMORAN OIL AND GAS COMPANY, a Delaware corporation; FREEPORT-McMORAN INC., a Delaware corporation; and FMP OPERATING COMPANY, a Texas Limited Partnership,
Plaintiffs-Appellees/Cross-Appellants,
v.
KN ENERGY, INC., A Kansas corporation,
Defendant-Appellant/Cross-Appellee.

Appeal from the United States District Court
For the District of Colorado
D.C. No. 85-Z-1081

Tucker K. Trautman, Lawrence P. Terrell, and D. Monte Pascoe of Ireland, Stapleton, Pryor & Pascoe, P.C., Denver, CO, on the briefs for *Plaintiffs-Appellees/Cross-Appellants.*

Robert L. Morris and P. Kathleen Lower of Morris, Lower & Sattler, Denver, CO; and Steve H. Ozawa of KN Energy, Inc., Lakewood, CO, on the briefs for *Defendant-Appellant/Cross-Appellee.*

Before MOORE and MCWILLIAMS, Circuit Judges, and BRATTON, District Judge.*

[August 19, 1991]

MOORE, Circuit Judge.

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* The Honorable Howard C. Bratton, Senior Judge, United States District Court for the District of New Mexico, sitting by designation.

In this case, we turn our attention to issues not addressed in a prior opinion in which we dismissed the action on jurisdictional grounds. *McMoran Oil and Gas Co. v. KN Energy, Inc.*, 907 F. 2d 1022 (10th Cir. 1990), *rev'd*, ____ U.S. ____, 111 S. Ct. 858 (1991). On the merits, McMoran Oil and Gas Company and its parent company, FreePort-McMoRan, Inc., (McMoRan collectively) and KN Energy, Inc., (KN or Buyer) now challenge the district court's interpretation of an amendment to the parties' gas purchase contract. KN raises additional evidentiary errors. We reverse and remand in part and affirm in part.

I.
BACKGROUND

In 1973, to insure against shortages in its supply of natural gas, KN, an interstate pipeline company, executed a gas purchase contract (the 1973 Contract) with a predecessor of McMoRan[1] in which the producer agreed to develop 475,000 acres of a gas field in the Bowdoin Unit, Phillips and Valley Counties, Montana, and to dedicate that production exclusively to KN for the life of the field. The 1973 Contract established a price of 50¢ per thousand cubic feet (MCF) to be increased at the end of each succeeding contract year by 1¢/MCF.

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[1] The 1973 Contract was executed with Midlands Gas Corporation, a wholly-owned subsidiary of KN, set up to explore and develop natural gas reserves. In 1983, KN created another subsidiary, Midlands Energy Company, to which the 1973 Contract was assigned. In the course of various acquisitions and exchanges of Midlands stock and in the face of a possibly unfriendly take-over, FreePort-McMoRan, Inc. (Freeport), McMoRan's parent company, acquired Midlands along with the 1973 Contract covering the Bowdoin Field. In 1985, McMoRan assigned the 1973 Contract to FMP Operating Company (FMPO), a limited partnership in which McMoRan and Freeport are general partners. In 1987, McMoRan amended its complaint to substitute FMPO as a plaintiff under Fed. R. Civ. P. 25(c), and McMoRan remained a party in the action. Thus, although FMPO is the real party in interest for purposes of the judgment and appeal, we shall continue to designate the original plaintiff as McMoRan to preserve a semblance of clarity in this case.

In 1975, the 1973 Contract was amended (the 1975 Amendment). In exchange for adding 123,000 acres to the originally dedicated field, McMoRan acquired the right to request renegotiation of the purchase price if Congress deregulated natural gas. (Exh. 2). In addition, ¶ 8.1F of the 1975 Amendment permitted McMoRan to request renegotiation every three years after the first renegotiated price became effective. During the interim three years of each renegotiation period, the price "shall increase one (1¢) per thousand (1,000) cubic feet until the effective date of each subsequent redetermined price."

Later, as a consequence of the newly enacted Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, and the substantially changed relationship between McMoRan and KN,[2] KN notified McMoRan that upon deregulation, it would pay 62¢/MCF, although it had previously paid a higher price for the same production. McMoRan responded by demanding the proper price be paid and later notified KN it would exercise its right to renegotiate the price as provided in ¶ 8.1F of the 1975 Amendment. According to McMoRan, the highest price "then being paid" for natural gas in the Bowdoin Area was the NGPA maximum lawful price for § 108 gas[3] "as determined from month-to-month based upon inflation and real growth factors and including tax reimbursement." (Exh. 28).[4] KN later responded under ¶ 8.1F, the "highest

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[2] McMoRan alleged that once KN's management sold its stock and spun off Midlands, KN, no longer negotiating as parent with a subsidiary, changed its position on price.

[3] Section 108 deals with stripper well gas. A stripper well produces such a small volume that its gross income "provides only a small margin of profit or in many cases, does not even cover actual cost of production." 8 H. Williams & C. Meyers, *Manual of Oil and Gas Terms* 947 (1987) (hereinafter *Manual of Oil and Gas Terms.)*. Under the NGPA, to be qualified as § 108 gas, in most cases, production cannot exceed 60 MCF/per day. In contrast, a high volume well could produce from two to ten/Mmcf per day. (R. IV, 62). Under the NGPA, § 108 gas was not deregulated and remained incentive priced.

[4] In February 1985, FERC's published § 108 price was $4.16.6/MBTU.

price" referred to the February 1985 "highest deregulated price" under § 103(b)(1)[5] of the NGPA or $2.96/MCF.

This diversity action for breach of contract followed.[6] McMoRan sought declaratory relief to determine the appropriate renegotiated price under ¶ 8.1F and damages for past under payments. After a two-day trial, the district court ruled from the bench that the " 'Highest price' means highest price and that 'highest price being paid for interstate or intrastate sold — similar quantities and qualities and being sold under similar terms and conditions: does not distinguish between regulated gas and unregulated gas.' (R. VI, 9). The Court found "the highest price then being paid was the regulated February, 1985 price," *id.* at 11, or $4.16.6/MMBTU, subject to an annual increase of 1¢/MMBTU. On that basis, the court ordered KN to pay to McMoRan $1,602,712.51, plus costs, for past underpayments.

McMoRan and KN cross appeal this order. McMoRan contends the court erred in not finding the § 108 *escalating* price "the highest price then being paid" and in failing to permit a 1988 step-up of that price as provided in ¶ 8.1F but not requested because of the still pending litigation.[7] KN urges error in the court's use of a regulated price as the highest price for deregulated gas. KN also complains the district court undercut its presentation of evidence by excluding certain testimony as well as other contracts to controvert McMoRan's case.

II.
DEREGULATION REDETERMINATION CLAUSE

As the district court correctly noted, this is a contract case in which we muster all of the tools of contract interpretation to decide what the parties meant and intended to do in ¶ 8.1F of the 1975 Amendment. This provision states:

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[5] Section 103 designates gas from new onshore production wells.

[6] All additional claims were settled before trial.

[7] Trial of this action was considerably delayed by the court's pressing criminal docket.

> In the event the Federal Power Commission or any successor governmental body shall cease during the term hereof to regulate the price to be paid hereunder, then within six months after such occurrence Seller shall have the right to request a renegotiation of the price to be paid hereunder. If Seller so requests a renegotiation of the price, Seller and Buyer shall determine the *highest price then being paid for natural gas by interstate or intrastate pipeland companies in Phillips or Valley Counties, Montana, for gas of similar quantity and quality and being sold under similar terms and conditions.* The price so determined shall be come [sic] effective upon the first day of the month six months after the date of cessation of price regulation. If said renegotiated price is put in effect, then three (3) years after the cessation of price regulation and every third year thereafter, Seller shall have the right to request a further renegotiation of the price to be paid hereunder. Each price so determined shall remain in effect for a period of one year, and at the beginning of each succeeding yearly period the price shall increase one (1¢) per thousand (1,000) cubic feet until the effective date of each subsequent redetermined price.

(Exh. 2) (emphasis added).

In oil and gas parlance, ¶ 8.1F embodies a type of escalator clause[8] tying a price renegotiation or an escalation in the contract price to the specific event of the deregulation of natural gas. The first sentence of ¶ 8.1F gives the Seller, McMoRan, the exclusive right to request a renegotiation of its sales of natural gas to KN "in the event" of deregulation. The second sentence is an area rate provision permitting an

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[8] Williams & Meyers reference six types of escalator clauses found in gas purchase contracts of which the renegotiation clause is one. "The 'renegotiation' . . . clause generally provides that at stated intervals — two, three, four or five years — there shall be a renegotiation or redetermination of the contract price based upon the current prices then being paid in the field." *Manual of Oil and Gas Terms* 317.

increase in the price of gas to equal "the highest price then being paid . . . in Phillips or Valley Counties, Montana, for gas of similar quantity and quality *and* being sold under similar terms and conditions." (emphasis added).

How to determine "the highest price then being paid" remains the rub of this litigation. Although there was uncontested evidence on the meaning of "similar quantity and quality,"[9] the parties disagreed on the import of "sold under similar terms and conditions." Relying on *Superior Oil Co. v. Western Slope Gas Co.*, 604 F.2d 1281 (10th Cir. 1979), the district court concluded that whether gas is regulated or deregulated does not comprise a condition of sale. Instead, conditions of sale, established in *Superior Oil*, referenced the "physical characteristics" of natural gas involved in a particular sale, for example, compression, deliverability, and treatment of the gas. (R. VI, 9).

However, this is a different case employing terminology not addressed by *Superior Oil*. In *Superior Oil*, the issue was whether vintaging,[10] a designation specifically used by the Federal Power Commission (FPC) in Area Rate Proceedings, is a "condition of sale" as that phrase was used in the favored nations clause[11] included in the parties' gas purchase contract. The *Superior Oil* court held it was not, unpersuaded that "well-drilling dates (vintage) constitute such 'attributes' or 'characteristics,' since there is no difference between 'old'

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[9] The parties stipulated in the Revised Pretrial Order, "The gas to which the redetermined price under the Midlands-KN contract applies is similar in quality to all other gas purchased by KN in February 1985 under that contract." Dr. William Talley, plaintiffs' expert, testified without contradiction that the designation of 'similar quantity' was included . . . to prevent a spurious contract for a very small quantity of gas from being used to set the price for contracts — other contracts; so it was a defining term to prevent abuse of this — under this clause." (R. VI, 60).

[10] Vintaging refers to the date on which a well is drilled.

[11] A favored nation clause is a type of area rate clause "increasing the price to be paid for natural gas by a purchaser to the seller-producer if any producer in the field receives a higher price for his gas than that stipulated in the contract." *Manual of Oil and Gas Terms* 574.

and 'new' gas for distribution or consumption purposes." *Id.* at 1291. Instead, *Superior Oil* stated, "conditions of sale" included those physical characteristics of natural gas, compression, deliverability, treatment of the gas, peaking capacity, as contemplated by the parties. Key to this conclusion was the considerable evidence of the parties' clear intention in drafting this provision to "*not* come under FPC control — at least insofar as gas purchased under the contract is concerned." *Id.* at 1289.

Thus, although *Superior Oil* assists in our analysis, the present case is distinguishable not only in the words used in ¶ 8.1F but also in the intention of the parties as manifest by that language. The gas to be sold under ¶ 8.1F was that sold both under similar terms and under similar conditions.

Before we consider extrinsic evidence to understand this language, we must look first to the meaning of the words themselves. In ¶ 8.1F, the use of the word "terms" is separate and distinct from that of "conditions." Indeed, the use of "terms" in this phrase is peculiar to the nomenclature of contract law and not a synonym nor interchangeable with "conditions." "A term of a contract is that portion of the legal relations resulting from the promise or set of promises which relates to a particular matter, whether or not the parties manifest an intention to create those relations." *Restatement (Second) of Contracts* § 5 (1981).[12] Such an agreed upon term, then, was the event of deregulation, and that was the only event which gave rise to McMoRan's right to seek a new price. Moreover, the clause intends deregulation to figure into the

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[12] The Comment to § 5 states:

> (a) *Agreed terms.* The terms of a promise or agreement are those expressed in the language of the parties or implied in fact from other conduct. Both language and conduct are to be understood in the light of the circumstances, including course of dealing or usage of trade or course of performance . . . . If a promise is binding, a term of the promise becomes a term of the contract unless it is rendered inoperative by some rule of law.

Restatement (Second) of Contracts § 5 (1981).

determination of the "highest price then being paid." This was a "term" of the sale.

The testimony established this provision was drafted in anticipation of price deregulation, with each party giving up certain consideration to implement the repricing mechanism.[13] The resulting natural gas price established by ¶ 8.1F was intended to exist only in a deregulated arena. While this deregulated setting may not be a "condition" of sale, it was contemplated as a "term" of sale. The "highest price then being paid" was for gas "sold under similar *terms* and conditions."

Given this reading, the "highest price then being paid" must be pegged to the highest free-floating market price under deregulation in Phillips or Valley Counties, Montana, existing at the time of renegotiation. Hence, the highest price under the terms of this contract cannot be "the frozen price" of § 108 gas, incentive-priced stripper gas not subject to deregulation.

Similarly, the highest price according to the language of this provision cannot be the highest *escalating* price as McMoRan urges. Paragraph 8.1F ties price to an area rate concept as the mechanism for escalation. This link is not an anachronism, as McMoRan contends, but reflects the intent of the parties faced with the prospect of deregulation. While the price to be set may reflect market fluctuations at agreed upon intervals, ¶ 8.1F contemplates incorporating the concept of escalation into an ultimately fixed price. To read price as that term is used in ¶ 8.1F as "pricing formula," as McMoran urges, injects a meaning that is neither supported by the plain language nor the parol evidence relied upon to interpret this provision.

The parties stipulated that in December 1984 under the 1973 Contract, "KN paid $4.118/MMBtu for dually qualified

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[13] In return for KN's giving McMoRan the right to request a renegotiation of price, McMoRan added 123,000 acres to the reserves already dedicated exclusively to KN for the life of the field.

Section 102/108 gas[14] and $3.845/MMBtu for singly qualified Section 102 gas.[15] On January 1, 1985, both singly qualified Section 102 gas and dually qualified Section 102/108 gas became deregulated."[16] Dr. Talley testified based on the Foster's Bulletin on Deregulated Gas, prepared from the Purchase Gas Adjustment Filings of interstate pipeline companies that the "average price being paid in the Bowdoin field for NGPA 102 deregulated gas purchases was $3.18 to $5.49.2/MMBTU." (R. IV, 54-55).[17] The highest price being paid in the area under a natural gas contract, Dr. Talley explained, was the § 108 escalating price. (R. IV, 56). The escalating § 108 price was $4.16.6/MMBTU in February 1985, and $5.37/MMBTU in October 1988.[18] However, the § 108 escalating price can only apply to gas specifically qualifying as § 108 gas. *Pennzoil Co. v. FERC*, 645 F.2d 360, 377, n.32 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). It cannot establish the price for all deregulated gas. *Id.*

The record discloses that the wells involved in the Bowdoin field included § 102, § 102/108, and § 108 wells. Although the parties stipulated to the December 1984 prices in the pretrial order, we cannot discern precisely from this record whether the stipulated price changed in February 1985 for deregulated § 102 and § 102/108 gas. Thus, we must remand this inquiry to the district court to make additional findings consistent with this opinion.

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[14] Section 102/108, "dually qualified gas," is deregulated under the NGPA.

[15] Section 102 new gas was deregulated.

[16] The parties also stipulated that the proper redetermined price is no less than the February 1985 NGPA § 103 (b) (1) ceiling price, $2.96/MMBTU. Although the record discloses that KN paid a § 103 price under some contracts, we find no evidence to consider this figure under the contract at issue.

[17] Dr. Talley corrected this statement upon realizing the figures covered the total Rocky Mountain area.

[18] Under the NGPA, the annual escalation was to apply indefinitely to § 108 gas. Other categories of gas had limitations placed on the duration of their annual escalations. *See Natural Gas Regulation Handbook*, ch. 3, at 46 (R. Pierce, Jr., ed. 1980).

However, the district court was correct in finding ¶ 8.1F fixed that price for a period of three years after deregulation at which time McMoRan could again exercise its right to request a renegotiation.[19] During the three-year interval, ¶ 8.1F provides a one cent, 1¢/MCF, increase "until the effective date of each subsequent redetermined price."

Despite this language, McMoRan challenges the court's refusal to allow the court-determined price to be " 'stepped up' to the Section 108 price as of June 30, 1988, the end of the second redetermination option." McMoRan concedes it did not make a timely written request as required by ¶ 8.1F but insists the equities of the situation would override such a "rigid enforcement of the contractual condition."[20]

However, in ¶ 8.1F, the parties intended to create a mechanism for setting and controlling the price of gas in the event of deregulation. By combining an escalation clause with a fixed price/fixed increase provision, as well as the procedure for triggering the price renegotiation, McMoRan and KN attempted, as the district court found, to maximize the incentives for which each bargained. Central to that contractual design is McMoRan's right to renegotiate. That right, the parties agreed, was triggered by McMoRan's request. The district court could neither anticipate McMoRan's making this request in 1988 nor do it for them. We find no abuse of discretion in the court's declining to modify the decree to provide for a 1988 renegotiation.

Finally, KN complains the court abused its discretion in refusing to add two defense witnesses and an exhibit shortly before trial was scheduled to commence.[21] The transcript of

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[19] Paragraph 8.1F states in part: "If said renegotiated price is put in effect, then three (3) years after the cessation of price regulation and every third year thereafter, Seller shall have the right to request a further renegotiation of the price to be paid hereunder."

[20] McMoRan relies on its record of vigorously pursuing this lawsuit in the face of the district court's scheduling problems.

[21] The testimony was offered to elucidate the source of the language contested in the 1975 Amendment and the negotiations related to that language in a contract with Odessa Natural Corporation.

this motion hearing on October 7, 1988, reveals the court thoughtfully balanced KN's proffer with McMoRan's showing of prejudice within the context of an inexorable trial schedule that had already significantly delayed the resolution of this action. Furthermore, despite the exclusion of this specific evidence, the court tempered the ruling by offering KN "leeway to present whatever evidence you need to present concerning what happened in the negotiations at the time of this contract and why language was changed and why it was added." (R. II, 16). There is, thus, no foundation in the record on which we can predicate an abuse of discretion.

We, therefore, *REVERSE* and *REMAND* the case for the sole purpose of determining the proper price as provided by ¶ 8.1F for deregulated § 102 and § 102/108 natural gas in February 1985 consistent with this opinion. We *AFFIRM* the court's order in all other respects.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Nos. 89-1068, 89-1098

McMORAN OIL AND GAS COMPANY, a Delaware corporation; FREEPORT-McMORAN INC., a Delaware corporation; FMP OPERATING COMPANY, a Texas Limited Partnership,

Plaintiffs-Appellees, Cross-Appellants,

v.

KN ENERGY, INC.

Defendant-Appellant, Cross-Appellee.

ORDER

Filed October 16, 1991

Before McKAY, Chief Judge, HOLLOWAY, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, AND EBEL, Circuit Judges, and BRATTON*, District Judge.

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*The Honorable Howard C. Bratton, Senior Judge, United States District Court for the District of New Mexico, sitting by designation.

This matter comes on for consideration of appellees' petition for rehearing and suggestion for rehearing en banc in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

In accordance with Rule 35(b) of the Federal Rules of Appellate Procedure, the suggestion for rehearing en banc was transmitted to all the judges of the court in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court

ROBERT L. HOECKER, Clerk

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Nos. 89-1068, 89-1098

McMORAN OIL AND GAS COMPANY, a Delaware corporation; FREEPORT-McMORAN INC., a Delaware corporation; FMP OPERATING COMPANY, a Texas Limited Partnership,

Plaintiffs-Appellees,

v.

KN ENERGY, INC.

Defendant-Appellant.

ORDER

Filed October 22, 1991

Before McKAY, Chief Judge, McWILLIAMS, HOLLOWAY, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, and EBEL, Circuit Judges, and BRATTON*, District Judge.

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*The Honorable Howard C. Bratton, Senior Judge, United States District Court for the District of New Mexico, sitting by designation.

In order to correct a clerical error in the issuance of this order on October 16, 1991, the court reissues the order to reflect the correct panel.

The order reissued nunc pro tunc and is to read as follows:

This matter comes on for consideration of appellees' petition for rehearing and suggestion for rehearing en banc in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

In accordance with Rule 35(b) of the Federal Rules of Appellate Procedure, the suggestion for rehearing en banc was transmitted to all the judges of the court in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court

ROBERT L. HOECKER, Clerk

By: _____
Patrick Fisher
Chief Deputy Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 85-Z-1081

McMORAN OIL AND GAS COMPANY, a Delaware corporation; FREEPORT-McMORAN INC., a Delaware corporation; and FMP OPERATING COMPANY, a Texas limited partnership.

Plaintiffs,

v.

K N ENERGY, INC., a Kansas corporation,

Defendant.

ORDER AND JUDGMENT

This diversity case was tried from November 17 through November 18, 1988, before the Honorable Zita L. Weinshienk, Judge. The issue was the price of natural gas on and after January 1, 1985, under a "take or pay" contract between plaintiffs and defendant. The trial proceeded to conclusion and the Court made oral findings of fact and conclusions of law which are incorporated herein by reference, as if fully set forth. In addition, the parties filed a Stipulation As To Damages on December 2, 1988. Accordingly, it is

DECLARED AND ADJUDGED that the price of gas under the contract is $4.166 per million British thermal units (MMBtu's), subject to a yearly increase of $.01 per MMBtu's. It is

ORDERED that judgment is entered in favor of plaintiffs McMoran Oil and Gas company, Freeport-McMoran, Inc., and FMP Operating Company, and against defendant K N Energy, Inc., in the amount of $1,602,712.51 plus costs. It is

FURTHER ORDERED that this judgment shall accrue interest at the rate of 9.20% per annum from the date of this judgment. It is

FURTHER ORDERED that plaintiffs shall have their costs upon the filing of a Bill of Costs with the Clerk of the Court within ten (10) days from entry of this Order and Judgment.

DATED at Denver, Colorado, this 28th day of December, 1988.

BY THE COURT:

ZITA L. WEINSHIENK, Judge
United States District Court

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. 85-Z-1081

McMORAN OIL AND GAS COMPANY, et al.,

Plaintiffs,

vs.

K N ENERGY, INC.,

Defendant.

REPORTER'S TRANSCRIPT
(Trial to Court: Bench Ruling)

Proceedings before the HONORABLE ZITA L. WEINSHIENK, Judge, United States District Court for the District of Colorado, commencing at 4:30 p.m., on the *18th day of November, 1988*, in Courtroom C-502, United States Courthouse, Denver, Colorado.

APPEARANCES

IRELAND, STAPLETON, PRYOR & PASCOE, by TUCKER K. TRAUTMAN and LAWRENCE P. TERRELL, Attorneys at Law, 1675 Broadway, Suite 2600, Denver, Colorado, 80202, and WILLIAM P. WARDEN, Attorney at Law, 1200 Fidelity Plaza, Oklahoma City, Oklahoma, 73102, appearing for the plaintiffs.

KELLY/HAGLUND/GARNSEY & KAHN, By EDWIN S. KAHN, Attorney at Law, 300 Blake Street Building, 1441

18th Street, Denver, Colorado, 80202; MORRIS, LOWER & SATTLER, by P. KATHLEEN LOWER, 7800 East Union Avenue, P.O. Box 38090, Denver, Colorado, 80237, and STEVE H. OZAWA, Attorney at Law, 12055 West 2d Place, Lakewood, Colorado, 80215, appearing for the defendant.

* * * * *

(The following proceedings were had and entered of record after the presentation of evidence and the arguments of counsel, at the conclusion of a two-day trial to court:)

RULING

THE COURT: Okay. This case is very fresh my mind. I've had a chance to look at all the exhibits, if not word for word, because some of them are very long, at least the critical parts of them. And I've had a chance to read or fast-read, skim, all the designated depositions. And I see no reason to delay issuing my decision. I don't think — I'll make it stronger than that: I am relatively sure that my decision would not be affected by more briefing, because I'm quite sure how this case must be decided.

We had this little fillip added just at the last minute, but it seems to me that this also can be adjusted and decided. So I will put my decision on the record at this time; and if you want to file motions and briefs, if I'm in error or if there is some case that you folks and I have overlooked that just came out that's important, I would be happy to have you do that; but I think and will find that nothing will be gained by any delay or by any post-trial briefs in this case.

The facts have been very clearly stated by both parties in trial briefs and other briefs and the pretrial order; and I don't think they need to be restated by me now, other than to perhaps just incorporate by reference what has been stipulated in the pretrial order. And I appreciate the stipulations that everybody made in this case. And of course, we are sitting in

the Tenth Circuit, and it's important that we look to the law of the Tenth Circuit, unless that law can be distinguished.

The issue is stated in — by both parties. The issues go to the 102 unregulated gas only. We're not talking about the pricing on the 108 or the 102/108; and so the issue is a very narrow issue, and that is under this contract, which is referred to as Amendment 1 — it's the 1975 contract between these two parties, who were at the time of the contract parent and subsidiary corporations — what is the meaning that should be given to paragraph 8.1F, which talks about what shall happen if there is deregulation and if the producer, the seller, requests a renegotiation of the price. And the interpretation of that language is what is before the Court.

Now, the case involves a lot of money, and I'm aware of that; and there has been an effort perhaps to bring to the Court's attention every single nitty-gritty detail. I think we do have very good attorneys on both sides. We also had very good attorneys before Mr. Kahn. I felt Mr. Morris did a very good job.

But when it boils down to the essence, the question is a contract case: and the question is what did the parties intend by the contract. And in a contract case, one looks to the plain words of the contract, one looks to the intent of the parties at the time, one looks to what the intent, actions, and words were before there was a dispute in this case; and there is done in every contract case. This is no different from any contract case; and the regular contract law, which is well known to both sides and the Court, comes into effect.

At the time of this particular contract that we're interpreting, interstate gas was regulated; intrastate gas generally was unregulated. At the time of this contract, there was, indeed, a unique relationship between the parties contracting, in that they were parent and subsidiary.

The Court would find that the weight of the evidence is that at the time of the contract, pipelines were seeking

reserves and were putting incentives into contracts so they could obtain these reserves. I think we had someone that put it in the negative: They were not giving disincentives. But the incentives were in the contract; and the Court is satisfied from the evidence in this case that the intent of the defendant was to encourage and give incentives to not only their subsidiary corporation but to others, because they weren't — they were trying very hard not to make any difference between how they treated their subsidiary and how they treated others. I think that's pretty clear from the testimony, also. Even though they were parent and subsidiary, the clear finding that I would get from the testimony is that K N wanted to give Midlands no more and no less than the other producers in this clause.

Now, at the time of this clause, obviously the parties did anticipate deregulation, because the clause talks about deregulation and what happens. Perhaps the bargaining parties were not aware of the details of what was going to happen under deregulation or the fact that it would come out as it came out; but certainly they were aware that there might be deregulation, and Mr. Wilson indeed said that he was aware of a variety of proposals.

In looking at the plain words of the contract, the Court notes that it does say, "the highest price then being paid," at the time of the renegotiation, which would indicate to the Court — and the testimony in this case — and I'm including the depositions and the exhibits — back up that that was the intent: to pay the highest price then being paid for natural gas. They say, "interstate or intrastate pipeline companies"; but the real words that we have to deal with in this case are the words "similar quantity and quality. . . similar terms and conditions."

"Similar quantity and quality," I think, was explained pretty well by Dr. Talley, who this court found to be a very knowledgeable and credible witness. He certainly has a distinguished background and a lot of experience in this area.

But as far as the definition of "quantity and quality," I don't think I have too much problem with that; and that is not the main concern. The party didn't want one-shot deals or a gas field which would just be in effect for a very short period of time, and this was explained very well by Dr. Talley's testimony.

The term is used in the contract "being sold under similar terms and conditions." Is gas which is regulated and is gas which is unregulated sold under similar terms and conditions? And that really is the heart of the issue before the Court. And what was the intent of the parties at the time of the contract, and what were their actions and words and conduct before the dispute arose?

Well, I think the Court has to agree that as far as actions and words around the time that this was being discussed, we do have Mr. Marsden's consideration about deregulated price, Mr. Sanders, and very importantly, Mr. Milligan. In the exhibits which have been presented to the Court, Mr. Milligan's interpretation or Mr. Milligan's view as stated in Exhibit 15 to Mr. Zinko. In the last paragraph, it indicates, "K N has a few additional contracts where the gas from certain wells will deregulate as of January 1, '85, that do not contain a clause permitting K N to market out. In almost all those contracts, only the seller can open the contract for a price redetermination. In those cases, with only minor exceptions, it is anticipated that the price paid for that gas will continue at the same level as before."

That also is the gist of his indication to Mr. Miller, who was inquiring about the price from the point of view of Midlands. And I'm trying to remember what that exhibit is.

MR. KAHN: 16 and 17, your Honor.

THE COURT: Is it 16 and 17? Well, certainly Midlands had some interest in trying to figure out what was going to happen to the price, because they were trying to sell this

interest, including the crown jewel, the Bowdoin — How do you pronounce it?

MR. KAHN: Bowdoin.

THE COURT: Bowdoin area; so it's understandable how with these two corporations and Midland trying to avoid the problems that they were having with people trying to have a takeover and looking for their white knight that they wanted to know about this. So even though Mr. Milligan very properly tells them that the legal department has not reviewed this and that their opinion would prevail over his, Mr. Milligan, who is a long-time employee of K N, who is an attorney, well respected, tells them that he is of the opinion — and this is the exhibit, 17 — that "The conclusions which you stated in your letter concur with my opinion as to the proper price to be paid for the gas sold under the above-noted contract upon deregulation."

And that was referring then to Exhibit 17 that it would continue — well, the letter from Mr. Miller says, "sales from all section 102 wells having first deliveries after January 1, '85, would receive the frozen section 102 price, the maximum lawful price for section 102 wells in effect on December 31, '84."

And basically, the conversation between Mr. Miller and Mr. Milligan through these letters and apparently otherwise was that the price would continue. And indeed, a very good price was paid for Midlands; and indeed, both Mr. Wilson, Mr. Milligan and probably others got extensive proceeds before K N changed their minds about the interpretation. And I think there was a change of mind, because it seems to me that in all of these exhibits which the Court has before it, the letters, the understanding of the participants, and also in the — the area — what are they called.

MR. TRAUTMAN: Area — oh, plans.

THE COURT: Action plans. The action plans. It was that anticipation that that price would continue, the higher price.

And all of this was really before the dispute, before — also before the proceeds went to the K N parties.

Two factors are very important in this case in reaching the conclusion that the contract really says what it appears to this court to say in plain language, and that is that "highest price" means highest price and that "highest price being paid for interstate or intrastate sold — similar quantities and qualities and being sold under similar terms and conditions" does not distinguish between regulated gas and unregulated gas.

The "similar terms and conditions" provision has been addressed not only by Dr. Talley but also by the Tenth Circuit. I recognize that *Superior Oil company v. Western Slope* was before the deregulation; but the language in that important decision — and that is an important decision, because I am bound by their wording in interpreting words very close to what we have in this contract. Instead of "similar terms and conditions," the words there were "similar conditions of sale," I believe.

But in that case, the court says the following — and for the record, *Superior Oil* is 604 F.2d 1281. It's a 1979 Tenth Circuit case, admittedly before deregulation, but nevertheless construing the words. And it indicates that the words "would appear to include all physical characteristics, including compression, deliverability, and treatment of the gas, but there is not reconcilable — " Wait a minute. I don't have to read all of this. Okay.

"Western Slope relies heavily on *Pur Oil*." And they cited for support of its position that "all factors, such as vintage, are relevant to determine price comparabilities, whether mentioned in the contract or not, should be considered." And then they go on to indicate that this language does not include "what we would now in this case refer to as the regulated vs. unregulated gas. The deregulated gas — " Wait a minute.

I have the language here out of the case, and I'm having trouble finding it; but I think generally in this case, it's very

clear that the decision of the Tenth Circuit which is to be followed indicates that such things as regulated gas vs. unregulated gas is not part of the conditions of sale or similar quantities and conditions or similar terms and conditions, as we have in this case.

And so as did *Superior Oil*, this court has to put itself in the position of the parties at the time of its execution and consider from the instrument the intent of the parties from the contract itself and from their actions; and doing that, and looking to the direction of *Superior Oil* — and I've just found the language: "Clearly conditions of delivery of the gas would not include the date of drilling of the wells."

Well, in any case, the physical characteristics of the gas — and I think this has been very clearly pointed out through the testimony — is considered in interpreting these words. The gas from a 108 well is the same as the gas from a 102 well; and the fact that one is regulated and the fact that the other is unregulated does not go to "similar terms and conditions."

The Court in addition to following the interpretation of *Superior Oil*, which I believe cannot be distinguished and does reach that conclusion, would rely also on the opinion of Dr. Talley, who the Court feels is, as I indicated, a very knowledgeable and credible witness. I agree with his evaluation.

Therefore, the Court would find that the plain words of the contract, the intent of the parties, which was to give the highest price at the time in order to get these reserves and to put incentives into the contract, and the interpretation of similar contracts by the Tenth Circuit all lead this court to reach the conclusion that we're talking about both regulated and unregulated gas and that the highest price then being paid was the regulated February, 1985 price, which was, according to the witness and other testimony, the $4.16 — 16.6 cents.

Now, I do agree with the defendants that I had some problems looking just to this contract, but I am also satisfied

by Dr. Talley's answer to my question that he did look at not one or two others, or refer to them, but some 11 or 12 other contracts in reaching the same amount. And the fact that the conditions may not have been precisely the same, as long as they were similar conditions, terms and conditions, that satisfies me. The then price, the frozen price, is the price testified to, $4.16.6 cents.

I also agree that that is frozen, and it should not be the adjustable price but it should be the frozen price increased by one cent a year, as stated in this contract. If I'm going to interpret this contract as it reads for the plaintiff, I'm also going to interpret it as it reads for the defendant, and that's what it says. It says "the then price being paid," which is the amount, at that point in time, at the time of the request for renegotiation. It increases one cent a year.

Now, what happens if there was not a request for renegotiation after three years and during the time of this contract? I can't assume that something is going to happen, unless there is something in writing that tells me that; so I agree with Mr. Kahn on this point that there was no request for renegotiation, nor any request made to the Court during the year 1988. And the next period of time for renegotiation of price is three years hence; and I hope I don't have to spell it out; that the parties can figure that out.

So the damages that will than allowed in this case — and I'm going to have some problems putting a specific dollar to it; you're going to have to do it for me — would be the damages based on the highest price, February, '85, that being $4 and 16.6 cents, increased one cent a year to the present time, and that's it. And I frankly haven't gone into detail on your damage stipulation. Does it cover this, or not?

MR. TRAUTMAN: Yes, it does, your Honor. The parties agree if the price selected by the Court is different, we will use the same methodology and substitute the Court's price and in

this case, the escalation factor. I think we can work that out in a relatively short time period.

THE COURT: I would like to have it worked out and I would like to see if I can get a stipulated agreement as to what that amount is.

By the way, I absolutely agree with Mr. Kahn that when you're talking about the then price, you can't talk about the settlement of 1988 settlement price. I think he's correct on that point. However, that is a moot issue, in view of the — what appears to me to be the clear contract interpretation. When people agree to a contract, they're bound by what they say. In this case, they're bound by what they say; and the contract has to be interpreted based on this clear meaning and based on the intent, which I've tried to do.

How soon can you get that stipulation to me?

MR. TRAUTMAN: (To Mr. Kahn) I can't read your lips.

MR. KAHN: We need about two weeks after you give it to us to review it.

THE COURT: I thought it was all stipulated. I was hoping to get it next week.

MR. TRAUTMAN: I think we can do it, depending on —

MR. KAHN: I don't anticipate any problem, your Honor. It's a question of the timing and the Thanksgiving holiday. I think we can try to turn it around in five to seven business days after he gives it to us. That's the best I think we can do. We don't want to hold it up, your Honor. It will make no difference in the long run, because we'll run through November 1 or whatever date we had in the earlier stipulation; and the Court can enter it as of that date. We understand the purport and effect of the Court's order, and we'll work with Mr. Trautman to get it done and get it done promptly. If we could have two weeks anyway to get this into you, it would help. I think we need five to seven days —

THE COURT: Could I have it two weeks from today, please. Would that be a problem?

MR. TRAUTMAN: That would be fine, your Honor.

MR. KAHN: We'll make every effort, your Honor.

THE COURT: Make your best efforts to get it to me by the 2d of December. If we go beyond that, we're really getting into a very busy preholiday time, and I want to get this judgment in.

The judgment therefore will enter for the plaintiff and against the defendant in an amount to be stipulated by the parties based on the statements of the Court, which are incorporated by reference. And all of my findings of fact and conclusions of law which I've stated on the record will be incorporated by reference. And when this case is appealed, which I assume it's going to be, you will get the transcript from the court reporter and that will stand as my decision in the case.

Now, are there any, before we leave in the few minutes we have left — are there any other findings that I may have neglected to make that you — either side feels are critical?

MR. KAHN: We have nothing further, your Honor.

MR. TRAUTMAN: Your Honor, we would assume that there ought to be a finding that you have jurisdiction of this case.

THE COURT: Oh. This court has previously found and will continue to find that it has jurisdiction to decide this whiskered case — it's one of the oldest — despite the problem concerning the partnership.

I realize that a record was made on that point, and that may be one of the points on appeal; but that came much too late, and the Court feels that there is jurisdiction to proceed. What else?

MR. TRAUTMAN: That's all I can think of, your Honor.

THE COURT: I meant to mention one other fact, and I think maybe I should. Mr. Kahn made a point about Uniform Commercial Code section 4-2-305: that when the parties really can't agree on a price, then they have to go to a reasonable price.

Well, in every contract dispute, one party, I guess, could unreasonably dispute how a contract is to be interpreted; and I don't think that that provision is to be read in order to undo contracts that fairly can be construed based on their language and intent. And for that reason, I cannot accept that argument.

MR. KAHN: Your Honor, there is one additional finding or correction you should make. I think when you started out, you said that only 102 gas and not 102/108 gas is involved in your determination. And I think you meant to say — and Mr. Trautman will agree with me — that this dispute that we're involved in here in court involves both 102 and —

THE COURT: 102/108.

MR. KAHN: The reason that that other category is involved is because of the *Martin* decision deregulating duly qualified gas. And although it's against the interest of my client to bring that to the Court's attention, rather than there being any misunderstanding —

THE COURT: I was assuming that was stipulated; but you may be right. Technically, it's not stipulated.

MR. TRAUTMAN: I think we did stipulate that there was no legal significance between the 102 and the 102/108, but I would second what Mr. Kahn —

THE COURT: All of the remarks that I had made about the 102 unregulated gas apply also to the 102/108 gas; and even though apparently there is stipulations about that, my remarks will apply to that gas, also. Thank you for bringing that to my attention.

I wanted to mention also there is another case besides the Tenth Circuit case, which is the Eighth Circuit case, the Arkansas case; and the Eighth Circuit, of course, is the sister circuit, and we look very carefully at Eighth Circuit law, because initially, before we were the Tenth, we were the Eighth Circuit here, some 60 years ago. And in that case, the court found, as I am finding here, that "similar quantity" refers to gas contracts of a shorter duration and not to whether the gas was regulated or not. That was a finding by another court that I think is entitled to some consideration, because that was in my opinion a well reasoned decision. That is *Louisiana-Nevada Transit v. Woods*, 390 F. Supp. 177. It's Western District of Arkansas, 1975.

While I'm talking about cases, the *Bowers* case did very specifically deal with Texas law and with a specific contract provision under Texas law and I think can be distinguished based on the fact that it was dealing with Texas law and Texas provisions and also should not be given that much weight, since it was after deregulation, because it was very soon after deregulation, before anyone really had a chance to think about the matters very deeply. And therefore, it seems to me that even though *Bowers* is after deregulation and superior is before deregulation that *Bowers* is not entitled to extra brownie points because of that fact; and *Superior*, because it is in the Tenth Circuit, is the court — is the case that governs this court.

Thank you very much; and two weeks from today, unless there is some problem, I will await your agreement and will then enter the judgment. And then you'll — your time for appeal will start running.

We have lots of exhibits.

If you'll hand me that, I'll sign it.

We have no place to keep exhibits, so all exhibits will be returned to the attorneys. I don't care if you want to not take them back today. It's — the big ones, anyway; but take back

the little ones and keep them. You'll have to hold them in a careful, secure place, until the Tenth Circuit wants them, if this case is going to be appealed.

And that reminds me of one last word that I really intended to state: I don't think it makes any sense for either side to spend two or three more years on an appeal in the Tenth Circuit and two or three more years on a appeal to the U.S. Supreme Court, if there is any possible way under the sun that you can resolve differences even at this late stage; so I would urge you to continue to talk together and see if you can come up with some solution to avoid the appeal.

I was just told by one of the circuit judges that the Tenth Circuit is, of all the circuits in the United States — has the biggest backlog and is most behind. So do what you can do, folks.

Thank you again. Court is in recess.

(Thereupon, the trial was concluded and the Court recessed at 5 p.m.)

* * * * *

REPORTER'S CERTIFICATE

I, Paul A. Zuckerman, Registered Professional Reporter and Official Reporter to this Court, do hereby certify that I was present at and reported in shorthand the proceedings in the foregoing matter; that I thereafter reduced my shorthand notes to typewritten form, comprising the foregoing official transcript; further, that the foregoing official transcript is a full and accurate record of the proceedings described in this matter on the date set forth.

Dated at Denver, Colorado, this 16th day of December, 1988.

Paul A. Zuckerman, CSR, RPR

Supreme Court, U.S.
FILED
FEB 12 1992
OFFICE OF THE CLERK

No. 91-1132

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

FREEPORT-MCMORAN INC., *et al.*,
Petitioners,

v.

K N ENERGY, INC.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF OF AMERICAN MINING CONGRESS AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Is a federal appellate court that reviews a decision arising under federal diversity jurisdiction obligated to follow state substantive law?

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BRIEF OF AMERICAN MINING CONGRESS AS AMICUS CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

INTEREST OF AMICUS CURIAE

The American Mining Congress files this brief *amicus curiae* pursuant to Rule 37.2 of the rules of this Court. Petitioners Freeport-McMoRan Inc., *et al.*, and respondent K N Energy, Inc., have consented to the filing of this brief.

Founded in 1897, the American Mining Congress is an industry association that encompasses (1) producers of most of America's metals, coal, industrial

and agricultural minerals; (2) manufacturers of mining and mineral processing machinery, equipment and supplies; and (3) engineering and consulting firms and financial institutions that serve the mining industry. Petitioner Freeport-McMoRan is a member.

The American Mining Congress is both a clearinghouse for information and a coordinator for action on behalf of the mining industry in the nation's capital. It keeps its members informed on matters pending in Congress, the Executive Branch and independent agencies, and works for constructive policies that will best enable the mining industry to serve the needs of the nation. It also marshals the cooperative endeavors of mine operators and equipment manufacturers in the interest of progress throughout the industry. In this regard, it vigorously promotes continuing modernization of mine operations and equipment to enhance safety, health, efficiency and product quality.

Members of the American Mining Congress operate in interstate commerce and from time to time litigate in the federal courts under diversity jurisdiction. Because they are involved in interstate commerce, members of the American Mining Congress are among the intended beneficiaries of federal diversity jurisdiction. "There is little doubt that the development of commerce has been aided by the existence of diversity jurisdiction. . . ." 1 J. Moore, J. Lucas, H. Fink, D. Weckstein & J. Wicker, *Moore's Federal Practice* ¶ 0.71[3.-2] at 701.33.

This past Term the American Mining Congress supported the petition of Freeport-McMoRan for another writ of certiorari in this case. There, the same panel of the U.S. Court of Appeals for the Tenth Circuit

that decided the case at bar had dismissed the suit holding that the addition of a non-essential, non-diverse affiliate destroyed diversity jurisdiction. This Court granted the writ and summarily reversed. *Freeport-McMoRan Inc. v. K N Energy, Inc.*, 111 S. Ct. 858 (1991) (per cur.), *rev'g McMoRan Oil and Gas Co. v. K N Energy, Inc.*, 907 F.2d 1022 (10th Cir. 1990).

Just as the court of appeals' decision in that earlier case threatened the stability and predictability of federal diversity jurisdiction, so the decision by that court in this case threatens the stability and predictability of the rules of decision that apply in cases decided under federal diversity jurisdiction. This issue is of strong and abiding concern to the membership of the American Mining Congress.

REASONS FOR GRANTING THE WRIT

The decision below conflicts with *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938). It does not conflict with that decision at its margins. It does not involve nice questions relating to the substance-procedure distinction or the interrelation of the Federal Rules of Civil Procedure and state law; the question of law faced by the court below is substantive by anyone's definition. *See Hanna v. Plumer*, 380 U.S. 460 (1965); *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945). Nor does the decision below purport to interpret the Constitution of the United States or any federal statute. Rather, the question addressed by the court is solely a matter of state law: whether the words "terms" and "conditions" in the phrase "terms and conditions" are interchangeable *salva veritate*. And under *Erie* that issue falls squarely within the province of state law.

Yet the court below made no attempt to apply state law. It cited no state authority, discussed no state cases, failed even to inquire which state's law applies. Indeed, the result reached by the court conflicts with state substantive law. The decision below therefore conflicts with *Erie*. In the exercise of its supervisory jurisdiction, this Court should reverse.

All of the principles underlying *Erie* stand as reasons for granting the writ and reversing the decision of the Tenth Circuit. By implicitly sanctioning two conflicting rules of law within a state—federal and state—the decision below undermines the certainty of legal rule that is a prerequisite to vigorous commerce. The decision promotes forum shopping and the inequities in administering justice that result from forum shopping. It also conflicts with federalism by permitting the intrusion by federal courts in state substantive matters. Finally, the decision imprudently encourages expansive use of the federal courts sitting in diversity.

The pragmatic justification for *Erie* is that it is patently undesirable to maintain conflicting sets of legal rules within a state. *E.g.*, *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941); *Hanna v. Plumer*, 380 U.S. 460, 468 (1965). Yet this is precisely what the Tenth Circuit has done. Before the court issued its decision, one could answer the question whether in Colorado the words "terms" and "conditions" are interchangeable. Now one can give only a conditional response: it depends on whether the litigation takes place in the state or the federal courts.

For firms that conduct business in interstate commerce the problem is one of cost. It is inefficient and ultimately costly to do business in a state under two

sets of legal precedents. Apart from considerations of cost, conflicting results in the state and federal systems are quite naturally viewed as unfair.

Another motivating force behind *Erie* is federalism, and the decision below conflicts with the principle of federalism. In *Erie*, that principle takes the following form: "There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a state whether they be local in their nature or 'general,' be they commercial law or part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts." 304 U.S. at 78. Years later Justice Harlan commented: "I have always regarded [*Erie*] as one of the modern cornerstones of our federalism, expressing policies that profoundly touch the allocation of judicial power between the state and federal systems." *Hanna v. Plumer*, 380 U.S. at 474 (Harlan, J., concurring). *See* Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U.L. Rev. 383 (1964). The decision below alters that allocation.

Yet another idea implicit in *Erie* is the undesirability of expanding the role of the federal courts in cases decided under state law. Creation of substantive rules in federal court that are at variance with the rules applied in state courts simply invites parties to litigate in federal courts unnecessarily. The decision below encourages unnecessary reliance on federal courts.

The duty to apply state law imposed by *Erie* includes a concomitant duty to ascertain what that law is. *E.g.*, *West v. American Telephone & Telegraph Co.*, 311 U.S. 223, 237 (1940); *Huddleston v. Dwyer*, 322

U.S. 232, 236 (1944). *Erie* did not "free the federal courts from the duty of deciding questions of state law in diversity cases. Instead it placed on them a greater responsibility for determining and applying state laws in all cases within their jurisdiction in which federal law does not govern." *Meredith v. City of Winter Haven*, 320 U.S. 228, 237 (1943).

The court below acknowledged that the issue it faced was a matter of contract interpretation: "[T]his is a contract case in which we muster all of the tools of contract interpretation to decide what the parties meant. . . ." Pet. App. A, 4. The court then ruled that "in the nomenclature of contract law" the word "terms" is not interchangeable with "conditions" and that the event of deregulation was an "agreed upon term" under the contract at issue. *Id.* at 7. Not once did the court advert to state law.

The only authority cited by the court was the *Restatement (Second) of Contracts* § 5 (1981). A *Restatement* section, of course, may be adopted by a state. In the present instance, however, neither Colorado nor Montana—the apparently relevant states—has adopted the *Restatement* section, nor did the court below suggest that either state had.

The court below did not say either that it had ignored state law or that it had applied federal general common law. But the decision itself shows that the court failed to apply state law, because the court's holding contradicts the law of the only two states whose substantive rules are potentially applicable under *Klaxon* and state conflicts law. Pet. 7, 8 nn.8, 9. One is left with the brute fact that the court applied its own law.

Erie, now more than fifty years old, has a well-known legacy of interpretive decisions and scholarly commentary. *See, e.g.*, Clark, *State Law in Federal Courts*, 55 Yale L.J. 267 (1974); Ely, *The Irrepressible Myth of Erie*, 87 Harv. L. Rev. 693 (1974); Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U.L. Rev. 383 (1964); Hart, *The Relations Between State and Federal Law*, 54 Colum. L. Rev. 489 (1954). Every nuance of the case has been analyzed.

This petition, however, raises an issue that is neither subtle nor arcane: must an appellate court reviewing a decision arising under diversity jurisdiction apply state substantive law? The essence of *Erie* is that it does; the apparent inability of the court below to answer this question correctly compels this Court to grant petitioners' writ.

CONCLUSION

For the reasons presented, the Court should grant the petition for writ of certiorari.

Respectfully submitted,

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BRIEF OF THE FERTILIZER INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

When private parties contract for the sale of goods in interstate commerce, may a federal court sitting in diversity disregard the applicable state law governing construction of contracts in favor of its own notion of federal common law rules of contract construction?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-1132

FREEPORT-MCMORAN INC., *et al.*,
Petitioners,

v.

K N ENERGY, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF THE FERTILIZER INSTITUTE AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

The Fertilizer Institute, on behalf of its member companies, submits this brief as *amicus curiae* in support of the petition by Freeport-McMoRan Inc. for a writ of certiorari to review the decision of the United States Court of Appeals for the Tenth Circuit reported at 942 F.2d 765.[1]

INTEREST OF AMICUS CURIAE

The Fertilizer Institute (TFI), a trade association of approximately 300 companies, represents the fertilizer industry in the United States. TFI's members and their affiliates have entered into countless contracts for the purchase and shipment of products in interstate com-

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[1] The petitioners and respondent have consented to the filing of this brief. The letters granting their consent have been filed with the Clerk of the Court.

merce. The Tenth Circuit's federal rule of contract construction, if allowed to stand, would apply to provisions which appear in many of those contracts. As the "Tenth Circuit definition" will often be contrary to the intent of the contracting parties, the parties' legitimate business expectations will be thwarted. Moreover, as the Tenth Circuit's ruling is irreconcilable with a Fifth Circuit holding, the law governing contracts covering interstate commerce will be confused and unsettled until this Court resolves that conflict. Faced with the potential disruptive effect on the interpretation of numerous contracts, TFI and its members have a vital interest in this Court's review of the decision below.

STATEMENT

The Tenth Circuit seems determined to overturn Freeport-McMoRan's trial verdict against respondent K N Energy, regardless of the precedent it sets. The district court entered that verdict in this contract dispute after considering extensive evidence regarding the parties' intent. On an appeal by K N Energy, the Tenth Circuit first overturned the verdict on jurisdictional grounds. Those grounds had never been briefed or argued by the parties, and the Tenth Circuit's decision conflicted with prior decisions by this Court and other circuits. Accordingly, this Court granted certiorari and summarily reversed. *Freeport-McMoRan Inc.* v. *K N Energy, Inc.*, 111 S. Ct. 858 (1991).

On remand, the Tenth Circuit once again overturned Freeport-McMoRan's verdict. This time, the Tenth Circuit fashioned a new federal rule of contract interpretation, contrary to both the applicable state law and the evidence of the parties' actual intent. Pet. App. at A-1, A-7. As before, the Tenth Circuit has miscalculated the power of a federal court sitting in diversity. In doing so, that court has created a troubling precedent conflicting with the holdings of this Court and at least one other Circuit. This Court therefore should grant certiorari to

review the Tenth Circuit's new decision or, as it did before, correct the error through summary reversal.

The pertinent factual background is straightforward and readily demonstrates the ramifications of the Tenth Circuit's decision. Freeport-McMoRan and respondent K N Energy are parties to a long-term contract for the purchase and sale of natural gas. Following changes in the natural gas market, a dispute developed regarding the meaning of the phrase "sold under similar terms and conditions." Invoking federal diversity jurisdiction, Freeport-McMoRan brought suit against K N in federal district court alleging breach of contract. After a full trial on the merits, the district court upheld Freeport-McMoRan's interpretation of that phrase, based on state law and extrinsic evidence of the parties' actual intent. Pet. App. A-18 through A-31.

The Tenth Circuit, in its second reversal, chose to ignore state law and, borrowing from the *Restatement of Contracts*, concocted a new legal definition for the disputed contract language. First, the court determined that in the contract phrase "terms and conditions," "the use of the word 'terms' is separate and distinct from that of 'conditions.'" Pet. App. at A-7. The court then defined the word "terms" as a matter of federal law to mean " 'that portion of the legal relations resulting from the promise or set of promises which relates to a particular matter, *whether or not* the parties manifest an intention to create those relations.' " Pet. App. at A-7 (*quoting Restatement (Second) of Contracts* § 5 (1981)) (emphasis added).

As a result, federal district courts within the Tenth Circuit must construe contracts containing the word "terms" consistently with the Tenth Circuit's definition and without regard to the contracting parties' actual intent. State courts within the Tenth Circuit, however, and other Circuits will continue to apply state law rules in the construction of contracts, following the same approach as the district court in this case. Thus, what the

Tenth Circuit has done is undeniable. It has tacitly fashioned a federal common law rule governing the construction of contracts.

REASONS FOR GRANTING THE WRIT

Certiorari is warranted for several reasons. First, the Tenth Circuit's decision is irreconcilable with *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938). The decision also conflicts with the Fifth Circuit's decision in *Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982).

Second, the decision below will disrupt the settled expectations of numerous other businesses. In light of *Erie*, contracting parties fully expect state law to govern the interpretation of their contracts. The Tenth Circuit's decision upsets that expectation, thereby potentially altering the interpretation of literally hundreds, if not thousands, of contracts which the parties contemplated would be interpreted by applying state rules of construction in the event of dispute.

Third, the Tenth Circuit's decision will create widespread uncertainty, due to the prevalent use of the phrase "terms and conditions" in American contracts. This uncertainty will also provoke unnecessary litigation as parties benefitting from the new federal interpretation contest the previously settled meaning of their contracts. In the ensuing litigation, the parties filing first in state courts and the Fifth Circuit will have their disputes decided under state law. Yet in the six states covered by the Tenth Circuit, "federal" law will apply to a suit brought in or removed to federal court.

A. The Tenth Circuit's Decision Directly Conflicts With This Court's *Erie* Standard And A Fifth Circuit Decision.

In *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938), this Court held that "[e]xcept in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State." 304 U.S.

at 78. Since *Erie*, this Court has emphasized and reemphasized "that where 'litigation is purely between private parties and does not touch the rights and duties of the United States,' " state law supplies the rule of decision. *Boyle* v. *United Technologies Corp.*, 487 U.S. 500, 506 (1988) (*quoting Bank of America Nat'l Trust & Savings Ass'n* v. *Parnell*, 352 U.S. 29, 33 (1956)).

The Tenth Circuit ignored *Erie* and construed the contract in disregard of state rules of contract construction. Colorado and Montana—the two states whose law might govern (*see* Pet. at 7-8)—require that contracts be interpreted consistent with the parties' intent.[2] In contrast, the Tenth Circuit concluded as a matter of federal law that there is a distinction between the meaning of the word "term" and the meaning of the word "condition," and then went on to define the word "term" also as a matter of law. Nowhere did the court consider whether the parties intended "term" to be given a technical legal definition or if the parties intended "terms" to be distinguished from "conditions".[3] Consequently, the Tenth Circuit's decision cannot be reconciled with the relevant state law. Indeed, the Tenth Circuit has tacitly, but undeniably, crafted its own federal common law rule. *Erie* forbids that result.

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[2] *See, e.g., Martinez v. Continental Enterprises*, 730 P.2d 308, 319 (Colo. 1986); *Foster v. Realty Title Co., Inc.*, 680 P.2d 323, 327 (Mont. 1984).

[3] Although the Tenth Circuit did suggest that its interpretation was consistent with the parties' intent, the court emphasized that "we must look first to the meaning of the words" as a matter of federal law and only then considered the parties' intentions in that light. Pet. App. A-7. The district court specifically found, after listening to the testimony at trial, that the parties actually intended just the opposite of what the court of appeals concluded. Pet. App. at A-25. The Tenth Circuit never even mentioned that finding or cited the relevant testimony, much less gave any reason for overturning the district court's findings of fact. *Compare* Pet. App. at A-9 (citing only testimony relating to current prices).

The Tenth Circuit's decision also conflicts directly with the Fifth Circuit's holding in *Pennzoil Co.* v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982). In *Pennzoil*, the court ruled that *Erie* requires that the FERC apply state law when interpreting contracts for the purchase of natural gas. 645 F.2d at 383-84. Notably, *Pennzoil* contrasted its holding with that of an earlier Tenth Circuit case which foreshadowed the erroneous reasoning now before this Court. Specifically, in *Public Serv. Co. of New Mexico* v. *FPC*, 557 F.2d 227 (10th Cir. 1977), the Tenth Circuit determined that "federal" law should be applied in interpreting a contract for the sale of federally regulated electricity, thus making it "unnecessary for us to examine New Mexico law . . . ." 557 F.2d at 231. Although the *Pennzoil* court attempted to distinguish *Public Service*, *see* 645 F.2d at 387 n.56, the Tenth Circuit's decision here extends even further the *Public Service* approach and demonstrates that the Circuit conflict is irreconcilable.

This conflict among the circuits by itself signals a need for review by this Court, even if that review is to summarily reverse the Tenth Circuit's decision. *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 66-67 (1966) (granting certiorari to resolve conflict in Circuits regarding the application of federal or state law to lease of federal lands). The disruptive consequences of the Tenth Circuit's decision make the need for review even more compelling.

B. The Tenth Circuit's Decision Will Revive Forum Shopping And Other Evils *Erie* Sought To Prevent.

In *Pennzoil*, the Fifth Circuit observed that allowing federal courts to create and apply federal common law in contract interpretation would result in the "very evil that *Erie* addressed . . . ." 645 F.2d at 384. Prior to *Erie*, under *Swift* v. *Tyson*, 41 U.S. 1 (1842), litigants who were able to establish diversity jurisdiction could have their disputes determined by a federal court apply-

ing federal common law principles. Similar litigants who were unable to establish federal court jurisdiction had their disputes litigated in state courts applying state law. This led to potential litigants playing musical states of residence to gain the advantage of either the state rule or the federal common law rule. *See Erie*, 304 U.S. 73-75. After commenting on *Swift*'s invitation to forum-shopping, the Court lamented that "the [*Swift*] doctrine rendered impossible equal protection of the law." *Erie*, 304 U.S. at 75.

Now, over fifty years after *Erie*, the Tenth Circuit has breathed new life into the *Swift* doctrine. The law of each state located within the Tenth Circuit requires courts to interpret contracts consistent with the intent of the parties.[4] To an unknown extent, but at least with respect to the ubiquitous word "terms," federal district courts in the Tenth Circuit will have to define certain words applying a technical legal definition, rather than the definition intended by the contracting parties. For the very reasons laid out in *Erie*, this Court should not tolerate such atavism. The *Swift* doctrine is dead for good reason, and this Court should not permit it to be revived in a disguised form.

The Tenth Circuit's decision invites forum shopping. If the state law favors the potential plaintiff, that party will file in the state court. If the state law is unfavorable, the federal court might prove a more advantageous forum. That was the problem with *Swift*; it was the reason for *Erie*.

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[4] *See, e.g., Winegar* v. *Froerer Corp.*, 813 P.2d 104, 108 (Utah 1991); *True Oil Co.* v. *Sinclair Oil Corp.*, 771 P.2d 781, 790 (Wyo. 1989); *City of Arkansas City* v. *Anderson*, 752 P.2d 673, 679 (Kan. 1988); *Martinez* v. *Continental Enterprises*, 730 P.2d 308, 319 (Colo. 1986); *Mercury Inv. Co.* v. *F.W. Woolworth Co.*, 706 P.2d 523, 529 (Okla. 1985); *Manuel Lujan Ins., Inc.* v. *Jordan*, 673 P.2d 1306, 1308 (N.M. 1983).

C. The Tenth Circuit Rule Will Create Havoc In Interpreting Numerous Outstanding Contracts.

The Tenth Circuit did not "interpret" some arcane word or phrase: It interpreted a word in a common contract phrase—the word "terms," in the phrase "similar terms and conditions." That phrase appears in literally hundreds of contracts to which TFI members are parties and in innumerable contracts of other types.[5]

The potential mischief of the Tenth Circuit's decision is far reaching. That Circuit has tacitly declared that it will displace state law and ignore the intent of the contracting parties, in favor of its own rules of construction and its own *ex cathedra* determination of what contract words mean. This Court has previously eschewed the adoption of such rigid, legalistic definitions when interpreting the words of a contract, and especially definitions that may be divorced from the parties' specific intent.[6]

Not only has the Tenth Circuit adopted an imprudent rule as the federal rule, but its decision will also create widespread uncertainty where the contracting parties previously believed that certainty existed. Contracting parties typically expect that their words will be construed consistent with their intent and the laws of a particular

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[5] *See, e.g., Modern Sys. Technology Corp.* v. *United States*, 24 Cl. Ct. 360, 362 (1991); *Dale Mortgage Bankers Corp.* v. *877 Stewart Ave. Assocs.*, 518 N.Y.S.2d 411, 412 (1987). *See also* 18 Am. Jur. 2d *Legal Forms* § 253:252 (provision using the phrase "terms and conditions"), § 253:1563 (provision using the phrase "terms and provisions").

[6] *See Skelly Oil Co.* v. *Phillips Petroleum Co.*, 339 U.S. 667, 678 (1950) (language in a natural gas contract was the same as that in a federal statute with a settled interpretation, but "this language in the contract may have a scope independent of the proper construction of [the language in the statute]. The same words, in different settings, may not mean the same thing."); *see also Columbia Gas Transmission Corp.* v. *Allied Chemical Corp.*, 652 F.2d 503, 508-09 (5th Cir. 1981) (holding that the term "inadvertence" in a gas contract should not be defined by application of the "technical definition" given the word when it appears in a federal rule of procedure).

state. For that reason, this Court has expressed repeated reluctance to displace state law where persons have formed such expectations. *See, e.g., Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 479 (1977); *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715, 729 (1979). The Tenth Circuit's decision is unfaithful to the spirit of those cases.

CONCLUSION

For these reasons, and the reasons set out in Freeport-McMoRan's petition, this Court should grant certiorari and either review the decision below on the merits or summarily reverse the Tenth Circuit panel again.

Respectfully submitted,

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FREEPORT-MCMORAN INC., et al.,

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BRIEF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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BRIEF OF THE INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA AS AMICUS CURIAE IN SUPPORT OF PETITIONER

On behalf of its member companies, the Independent Petroleum Association of America submits this brief as *amicus curiae* in support of the petition by Freeport-McMoRan Inc. for a writ of certiorari to review the decision of the United States Court of Appeals for the Tenth Circuit, reported at 942 F.2d 765 (1991).[1]

INTERESTS OF AMICUS CURIAE

The Independent Petroleum Association of America ("IPAA") is a trade association that represents independent oil and gas producers in the United States. IPAA has approximately 5,500 members, and IPAA's mem-

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[1] The petitioners and respondent have consented to the filing of this brief. The letters granting their consent have been filed with the Clerk of the Court.

bers produce the vast majority of natural gas in the United States.

IPAA's members are parties to a broad variety of contracts used to conduct their business. These include leases, exploration agreements, farmout agreements, drilling agreements, pooling agreements, unitization agreements, operating agreements, balancing agreements, and natural gas sales agreements.

Independent producers rely on these contracts, and their application under state law, in making the large capital investments required to explore for and develop natural gas reserves. Because the Tenth Circuit's decision, establishing a new federal rule of contract law, could have an extremely disruptive impact on the way that IPAA's members conduct and structure their business transactions, IPAA has a significant interest in this Court's review of the decision below.

STATEMENT

Freeport-McMoRan Inc. ("Freeport"), et al., the petitioners here and plaintiffs below, obtained a judgment in their favor in the United States District Court for the District of Colorado after a full trial on the merits in November 1988. Subject matter jurisdiction was based on diversity of citizenship. Relying on extensive extrinsic evidence, the district court found that a provision in a natural gas sales contract allowing the seller to redetermine the price to the highest price paid for gas "sold under similar terms and conditions" was not intended to exclude prices paid for regulated gas.

A panel of the Tenth Circuit reversed the judgment of the district court, ruling that the addition of a party after the suit had been filed destroyed diversity jurisdiction. The Supreme Court reversed the Tenth Circuit, *Freeport-McMoRan Inc. v. K N Energy, Inc.*, __ U.S. __, 111 S.Ct. 858 (1991).

On August 19, 1991, the same panel of the Tenth Circuit reversed the district court again. The appellate court held that the "use of 'terms'," in the contract's redetermination provision referring to gas "sold under similar terms and conditions," is "not a synonym nor interchangeable with 'conditions'." App. p. A-7. On the basis of this distinction, the court concluded that deregulation "was a 'term' of the sale" although it was not a "condition" of the sale. App. pp. A-7, A-8.

As in its previous decision, the Tenth Circuit has ignored the settled boundaries delimiting the power of a federal court sitting in diversity. The court has, in effect, created a federal rule of contract law distinguishing between "terms" and "conditions" regardless of the parties' actual intent. The holding not only conflicts with the decisions of this Court and of another Circuit, but also defeats the parties' expectation that state law, which does not recognize the Tenth Circuit's distinction, would govern the construction of their contract. This Court should undo the mischief by granting the petition or, as it did previously, correct the error by summary reversal.

REASONS FOR GRANTING THE WRIT

This Court should review the decision below for several reasons. *First,* the Tenth Circuit's decision conflicts with the settled rule that there is no federal general common law.

Second, the decision creates serious uncertainty in the enforcement of contracts, which frequently use the words "terms and conditions" or similar phrases.

I. The Tenth Circuit's Decision Directly Conflicts With The Settled Rule That There Is No Federal General Common Law.

In *Erie R. Co. v. Tompkins,* 304 U.S. 64 (1938), this Court held that "[e]xcept in matters governed by the Federal Constitution or by Acts of Congress, the law to

be applied in any case is the law of the state." 304 U.S. at 78. In the construction of gas purchase contract clauses very similar to the dispute at issue here, this Court has noted "that the interpretation of the favored nations clause raises only questions of state law." *Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 579 n. 9 (1981). The Tenth Circuit's decision, tacitly creating a federal common law rule of contract construction, simply cannot be reconciled with the teaching of *Erie* and *Arkansas Louisiana.*

The Tenth Circuit's decision also conflicts directly with the Fifth Circuit's holding in *Pennzoil Co. v. FERC,* 645 F.2d 360 (5th Cir. 1981), cert denied, 454 U.S. 1142 (1982). *Pennzoil* held that the Federal Energy Regulatory Commission must apply state law in determining whether gas purchase contracts authorize collection of federal ceiling prices. *Pennzoil* also explicitly held that "the federal legislation and regulation of this area does not directly address the interpretation of gas purchase escalation provisions." 645 F.2d at 385.[2] To resolve this conflict between the Circuits as well as to deter the very type of forum shopping *Erie* was designed to prevent, this Court should review the decision below.

II. The Tenth Circuit's Holding Will Cloud Numerous Contracts And Cause Turmoil.

The "terms and conditions" phrase which is the subject of the Tenth Circuit's new rule of contract interpretation is rife in gas purchase contracts[3] and other contracts used in the oil and gas industry. These contracts

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[2] Reliance on substantive state law is all the more appropriate because all federal price controls on "first sales" of natural gas will be phased out by January 1, 1993. See Wellhead Price Decontrol Act of 1989, Pub. L. 101-60, 103 Stat. 157 (July 26, 1989).

[3] See, e.g., D. JOHN, N. HENGERER & P. ESPOSITO, NATURAL GAS CONTRACTS, §§ 58.023, 58.025, and App. I (1984) (model contract provisions); *Superior Oil Co. v. Western Slope Gas Co.,* 604 F.2d 1281, 1284 (10th Cir. 1979).

typically involve millions of dollars of revenues and affect the delivery of a commodity which serves millions of residential and commercial end-users. Hence, the Tenth Circuit decision to, in effect, supplant state law in favor of that court's newly invented, nebulous distinction between "terms" and "conditions" will not only cloud the administration of numerous contracts essential to the day-to-day operations of the oil and gas industry. The disruption caused to this critical industry through the uncertainty and litigation generated by the Tenth Circuit will ultimately be felt across the nation by those whom the industry serves — business and household alike. Review of the decision below is therefore indispensable in order to restore the contract certainty upon which this industry and its customers rely.

CONCLUSION

For the foregoing reasons, this Court should either grant the petition and review the decision below on the merits or summarily reverse this Tenth Circuit panel again.

Respectfully submitted,

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